

**PROJECT NO. 31111**

<b>RULEMAKING TO ADDRESS AN</b>	<b>§</b>	<b>PUBLIC UTILITY COMMISSION</b>
<b>INDEPENDENT MARKET MONITOR</b>	<b>§</b>	
<b>FOR THE WHOLESALE ELECTRIC</b>	<b>§</b>	<b>OF TEXAS</b>
<b>MARKET IN ERCOT</b>	<b>§</b>	

**PROPOSAL FOR PUBLICATION OF NEW §25.365  
AS APPROVED AT THE OCTOBER 28, 2005 OPEN MEETING**

The Public Utility Commission of Texas (commission) proposes new §25.365, relating to an Independent Market Monitor (IMM) for the Wholesale Electric Market in the Electric Reliability Council of Texas (ERCOT). The proposed new rule is necessary to protect the public interest by detecting and preventing market manipulation strategies, market rule violations, and market power abuses in the ERCOT wholesale electric market and by recommending measures to enhance the efficiency of the wholesale market. This rule is a competition rule subject to judicial review as specified in PURA §39.001(e). Project Number 31111 is assigned to this proceeding.

The proposed new rule, if adopted, will implement the requirements of Senate Bill 408. The bill requires that the commission adopt rules that: (1) define the responsibilities and authority of the IMM; 2) establish the standards for funding the IMM; 3) specify the staffing requirements and qualifications for the IMM; and 4) establish ethics standards for the IMM. The proposed rule also specifies the relationship of the IMM to the commission and to ERCOT.

Mr. Jeffrey T. Pender, Attorney, Legal Division, has determined that for each year of the first five-year period the proposed section is in effect there will be no fiscal implications for state or local government as a result of enforcing or administering the section.

Mr. Pender has determined that for each year of the first five years the proposed section is in effect the public benefits expected as a result of adoption of the proposed rule will be the facilitation of a more effective and efficient operation of the wholesale electric markets. The Texas Legislature has determined that Texas should change from a system in which electric power is fully regulated by the commission to a system in which competitive forces will determine the rates, operations, and services that are available to the public. The Legislature has directed that the commission put in place an independent market monitor to oversee the activities of market participants in the newly instituted wholesale electric market in ERCOT to ensure that the market remains free of strategic manipulations and market power abuses and brings the benefits of competition to electric customers. The public benefits anticipated as a result of this rule include the protection of customers and market participants from market manipulations, market rule violations, and market power abuses, and the increased efficiency of market operations.

There is no anticipated economic cost to persons who are required to comply with the proposed section.

There will be no adverse economic effect on small businesses or micro-businesses as a result of enforcing the proposed section.

Mr. Pender has also determined that for each year of the first five years the proposed section is in effect there should be no negative effect on a local economy, and therefore no local employment

impact statement is required under Administrative Procedure Act (APA), Texas Government Code §2001.022.

The commission staff will conduct a public hearing on this rulemaking under the Administrative Procedure Act, Texas Government Code §2001.029 at the commission's offices, located in the William B. Travis Building, 1701 North Congress Avenue, Austin, Texas 78701, on Monday, January 9, 2006, at 9:30 a.m.

Comments on the proposed new section (16 copies) may be submitted to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, PO Box 13326, Austin, Texas 78711-3326, within 31 days after publication. Reply comments may be submitted within 45 days after publication. Comments should be organized in a manner consistent with the organization of the proposed rule. The commission invites specific comments regarding the costs associated with, and benefits that will be gained by, implementation of the proposed section. The commission will consider the costs and benefits in deciding whether to adopt the section. All comments should refer to Project Number 31111.

When commenting on specific subsections of the proposed rule, parties are encouraged to describe "best practice" examples of regulatory policies, and their rationale, that have been proposed or implemented successfully in other states already undergoing electric industry restructuring, if the parties believe that Texas would benefit from application of the same policies. The commission is only interested in receiving "leading edge" examples which are

specifically related and directly applicable to the Texas statute, rather than broad citations to other state restructuring efforts.

This new section is proposed under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2005) (PURA), which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, PURA §39.1515, which requires that the commission select an entity to act as the commission's wholesale electric market monitor to detect and prevent market manipulation strategies and recommend measures to enhance the efficiency of the wholesale market; PURA §35.004, which requires that the commission ensure that ancillary services necessary to facilitate the transmission of electric energy are available at reasonable prices with terms and conditions that are not unreasonably preferential, prejudicial, predatory, or anticompetitive; PURA §39.001, which establishes the Legislative policy to protect the public interest during the transition to and in the establishment of a fully competitive electric power industry; PURA §39.101, which establishes that customers are entitled to protection from unfair, misleading, or deceptive practices and directs the commission to adopt and enforce rules to carry out this provision and to ensure that retail customer protections are established that afford customers safe, reliable, and reasonably priced electricity; PURA §39.151, which requires the commission to oversee and review the procedures established by an independent organization, directs market participants to comply with such procedures, and authorizes the commission to enforce such procedures; and PURA §39.157, which directs the commission to monitor market power associated with the generation, transmission, distribution, and sale of

electricity and provides enforcement power to the commission to address any market power abuses.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.1515, 35.004, 39.001, 39.101, 39.151, 39.157, 39.356, and 39.357.

**§25.365 Independent Market Monitor.**

- (a) **Purpose.** The purpose of this section is to define the responsibilities and authority of the independent market monitor (IMM) for the Electric Reliability Council of Texas (ERCOT) wholesale markets, establish the standards for funding the IMM, specify the staffing requirements and qualifications for the IMM, and establish ethics standards for the IMM. This section also specifies the relationship of the IMM to the commission and to ERCOT.
- (b) **Definitions.** The following words and terms when used in this section shall have the following meaning, unless the context indicates otherwise:
- (1) IMM - Depending on the context, the office of the IMM or the director of the IMM and its staff.
  - (2) Market participant – Any person or entity participating in the power region’s wholesale markets, including, but not limited to, a load-serving entity (including a municipally-owned utility and an electric cooperative), a retail electric provider, a qualified scheduling entity, a power marketer, a transmission and distribution utility, a power generation company, a qualifying facility, an exempt wholesale generator, a load acting as a resource, and any entity conducting planning, scheduling, or operating activities on behalf of such market participants.
  - (3) Market – The course of commercial activity by which the exchange of goods or services is effected. As used in this section, the term may refer to a market or a submarket of a market.

- (4) Protocols – The documents that contain the scheduling, operating, planning, reliability, and settlement procedures, standards, and criteria in effect in the markets administered by ERCOT.
- (c) **Objectives of market monitoring.** The IMM shall monitor wholesale market activities so as to:
- (1) Detect and prevent market manipulation strategies and market power abuses; and
  - (2) Evaluate the operations of the wholesale market and the current market rules and proposed changes to the market rules, and recommend measures to enhance market efficiency.
- (d) **Responsibilities of the IMM.** The IMM shall gather and analyze information and data as needed for its market monitoring activities. The duties and responsibilities of the IMM may include:
- (1) Monitoring all markets in the power region for energy, capacity services, and congestion revenue rights, and ERCOT's protocols, procedures and practices that affect supply, demand, and the efficient functioning of such markets;
  - (2) Developing and regularly monitoring market screens and indices to identify abnormal events in the power region's wholesale markets;
  - (3) Analyzing events that fail the screens, and other abnormal activities and market events, using computer simulation and advanced quantitative tools as necessary;
  - (4) Developing and regularly monitoring performance measures to evaluate market participants' and ERCOT's compliance with the protocols and the effectiveness of ERCOT's system operations;

- (5) Conducting market power tests and other analyses related to market power determination;
  - (6) Analyzing ERCOT's market rules and proposed changes to those rules to identify opportunities for strategic manipulation and other economic inefficiencies, as well as potential areas of improvement to harmonize reliability standards and market efficiency;
  - (7) Conducting investigations of specific market events;
  - (8) Providing expert testimony services on behalf of commission staff in enforcement proceedings or other commission proceedings;
  - (9) Maintaining a market oversight website to share market information with the public;
  - (10) Preparing market monitoring reports as required under subsection (k) of this section; and
  - (11) Performing any additional duties required by the commission.
- (e) **Authority of the IMM.**
- (1) The IMM has the authority to conduct monitoring and related activities but has no enforcement authority.
  - (2) The IMM has the authority to require submission of any information and data it considers necessary to fulfill its monitoring and investigative responsibilities by ERCOT and by market participants. Market participants and ERCOT shall provide complete, accurate, and timely responses to all IMM requests for documents, data, information, and other materials.

- (3) The IMM may require that each market participant designate a contact person that can answer questions the IMM may have regarding a market participant's operations or market activities.
- (f) **Selection of the IMM.** ERCOT and the commission shall contract with an entity selected by the commission to act as the commission's wholesale market monitor. The IMM shall be established as an office independent from ERCOT, and is not subject to the supervision of ERCOT with respect to its monitoring and investigative activities.
- (g) **Funding of the IMM.** The budget and expenditures of the IMM are subject to commission supervision and oversight. Financial controls and reporting procedures shall be implemented by the IMM and ERCOT to ensure that expenditures are consistent with the approved budget and with this section.
- (1) ERCOT shall fund the operations of the IMM using money from the fee authorized by PURA §39.151.
  - (2) The funding of the IMM shall be sufficient to ensure that the IMM has the resources and expertise necessary to monitor the wholesale electric market effectively, as determined by the commission.
  - (3) ERCOT shall maintain separate accounts of expenditures in support of the IMM.
  - (4) ERCOT shall directly assign costs to the IMM whenever possible. To the extent overhead and shared expenses cannot be directly assigned, ERCOT shall allocate such expenses to the IMM based on appropriate cost causation factors. ERCOT shall maintain all records and workpapers necessary to substantiate all direct charges and allocations to the IMM.

(h) **Staffing requirements and qualification of IMM director and staff.**

- (1) The director of the IMM shall have the qualifications necessary to oversee performance of the duties and responsibilities in subsection (c) of this section. The staff of the IMM shall have the qualifications needed to perform the market monitoring functions in subsection (c) of this section. The IMM director and staff shall be subject to background security checks as determined by the commission.
- (2) The staff of the IMM shall collectively possess a set of technical skills necessary to perform market monitoring functions, which typically includes economics, with a focus on market analysis and market competitiveness; power engineering; statistics and programming; and modeling, with a focus on optimization modeling.

(i) **Ethics standards governing the IMM director and staff.**

- (1) During the period of a person's service with the IMM, the IMM director and an IMM employee shall not:
  - (A) have a professional or financial interest in a market participant or an affiliate of a market participant; or own shares in a company that provides consulting services to a market participant;
  - (B) serve as an officer, director, partner, owner, employee, attorney, or consultant for ERCOT or a market participant or an affiliate of a market participant;
  - (C) directly or indirectly own or control securities in a market participant, an affiliate of a market participant, or direct competitor of a market participant or affiliate, except that it is not a violation of this rule if the

IMM director or an IMM employee indirectly owns an interest in a retirement system, institution or fund that in the normal course of business invests in diverse securities independently of the control of the IMM director or employee; or

(D) accept a gift, gratuity, or entertainment from ERCOT, a market participant, affiliate of a market participant, or an employee or agent of a market participant or affiliate of a market participant.

(2) The IMM director or an IMM employee shall not directly or indirectly solicit, request from, suggest, or recommend to a market participant or affiliate of a market participant, or an employee or agent of a market participant or affiliate of a market participant, the employment of a person by a market participant or affiliate.

(3) The commission may impose post employment restrictions for the IMM and its employees.

(j) **Confidentiality standards governing the IMM director and staff.**

(1) The IMM shall protect confidential information and data in accordance with the confidentiality standards established in PURA, the protocols, commission rules, and other applicable laws.

(2) Unless otherwise notified by the commission legal staff, the IMM may not communicate with a market participant or with an ERCOT board member, officer, or employee concerning a particular subject matter once the commission legal staff notifies the IMM that the subject matter is, or may be, the subject of an investigation or enforcement proceeding.

(k) **Reporting requirement.** The IMM shall prepare and submit to the commission the following reports:

- (1) Daily, monthly, and quarterly reports on prices and congestion;
- (2) An annual report on the state of the market, which will include an assessment of the competitiveness of the market; an assessment of the efficiency of ERCOT's management of the balancing energy, ancillary services, and congestion rights markets; an evaluation of the effectiveness of congestion management by ERCOT; an evaluation of whether there are inappropriate incentives, flaws, inefficiencies, and opportunities for manipulation in the market design; and any recommendations for improving the market design; and
- (3) Periodic or special reports on market conditions or specific events as directed by the commission.

(l) **Communication between the IMM and the commission.** The personnel of the IMM may communicate with commission staff on any matter without restriction. The IMM shall:

- (1) Immediately report directly to the commission abnormal bids or offers, abnormal operational or market behavior by either a market participant or ERCOT, any potential market manipulation, and any discovered or potential violations of commission rules or rules of ERCOT;
- (2) Regularly communicate with the commission staff, and keep the commission updated regarding its activities, findings, and observations;
- (3) Coordinate with the commission to identify priorities;

- (4) Coordinate with the commission to assess the resources and methods for monitoring the wholesale market effectively, including consulting needs; and
  - (5) Refer instances of possible market manipulation, market power abuse, and violations of commission rules or ERCOT protocols to the commission.
- (m) **ERCOT's responsibilities and support role.** ERCOT shall provide the IMM director and staff full access to its operations centers, staff, and records relating to operations, settlement, and reliability. ERCOT shall designate liaisons to facilitate communications with the IMM on ERCOT's operations and information technology.
- (1) ERCOT shall develop and operate an information system to collect and to store data required by the protocols, and shall provide adequate communication equipment and necessary software packages to enable the IMM to establish electronic access to the information system and to facilitate the development and application of quantitative tools necessary for the market monitoring function. Data from ERCOT's source systems must be capable of being replicated in near real time and available for query by the IMM until data are archived and archived data are accessible for high-speed information searches. Data archives must be designed to accommodate remote access by the IMM and the commission staff at any time.
  - (2) On an ongoing basis, ERCOT shall implement necessary procedures for the accurate collection and storage of data in the data archives and accurate communication of those data for use by the commission staff and the IMM.
  - (3) The IMM may review the catalogs of information and data and data collection verification criteria developed by ERCOT and may propose changes, additions, or

deletions to the catalogs and criteria to facilitate the market monitoring function.

In so doing, the IMM may require database items or evaluation criteria for inclusion in the pertinent catalogs.

- (4) ERCOT shall establish procedures to ensure that the IMM may access all data maintained by ERCOT relating to operations, settlements, and reliability.
- (5) ERCOT may provide administrative support and goods and services to the IMM, such as office space, payroll, and related services, and information technology support.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

**ISSUED IN AUSTIN, TEXAS ON THE 28<sup>th</sup> DAY OF OCTOBER 2005 BY THE  
PUBLIC UTILITY COMMISSION OF TEXAS  
ADRIANA A. GONZALES**